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COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

)  
Joint Petition of Fall River Gas Company ) D.T.E. 00-25  
And Southern Union Company for )  
Approval of Merger )  
)

POST-HEARING BRIEF OF JOINT PETITIONERS

FALL RIVER GAS COMPANY AND SOUTHERN UNION COMPANY

I. INTRODUCTION

On January 27, 2000, Fall River Gas Company ("Fall River") and Southern Union Company ("Southern Union") (collectively the "Joint Petitioners") filed with the Department of Telecommunications and Energy (the "Department") a petition requesting the Department's approval of the merger of Fall River with and into Southern Union pursuant to G.L. c. 164, § 96 (Petition at 1). In addition, the Joint Petitioners requested that the Department determine that any transfer of Fall River's franchise that may be deemed to occur as a result of the mergers and related transactions is approved in accordance with G.L. c. 164, § 96, and therefore, no approval by the Massachusetts General Court is required under G.L. c. 164, § 21 (id.). This post-hearing brief is submitted in support of the proposed merger in accordance with the briefing schedule established by the Hearing Officer on June 2, 2000.

As discussed herein, the record in this proceeding demonstrates that customers will experience no net harm as a result of the Department's approval of the proposed mergers. In addition, as directed by the Hearing Officer, the Joint Petitioners herein address the following issue: the potential for conflicting state regulatory determinations on financing proposals, which are subject to review by the Department as well as public utility commissions in other jurisdictions in which Southern Union operates (Tr. at 78).

The Joint Petitioners respectfully submit that the proposed merger is consistent with the public interest as required by G.L. c. 164, § 96 and should be approved by the Department.

II. PROCEDURAL HISTORY

On April 6, 2000, pursuant to notice duly issued, the Department conducted a public hearing and procedural conference at its offices in Boston, Massachusetts. The Attorney General intervened in this proceeding as a matter of right. The Department granted limited participant status to the Commonwealth of Massachusetts Division of Energy Resources. The Department conducted a public hearing in Fall River, Massachusetts on April 11, 2000 and evidentiary hearings on June 2, 2000. The Joint Petitioners presented four witnesses: (1) Peter H. Kelley, President and Chief

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Operating Officer of Southern Union; (2) Ronald J. Endres, Executive Vice President and Chief Financial Officer of Southern Union, (3) Peter H. Thanas, Senior Vice President, Treasurer and Chief Financial Officer of Fall River Gas Company, and (4) Orlando M. Magnani, Principal of Navigant Consulting, Inc.

The evidentiary record consists of approximately 82 exhibits, including responses to information requests and record requests, and the sworn testimony presented at hearing (Tr. at 117-118).

In addition, the Joint Petitioners entered into an agreement (the "Settlement Agreement") with the Attorney General, which was provided to the Department for informational purposes on June 6, 2000. The Settlement Agreement provides, *inter alia*, that the Attorney General has no objection to the Department granting the relief requested by the Joint Petitioners, including approval of the merger pursuant to G.L. c. 164, § 96 in consideration for certain commitments made to the Attorney General by the Joint Petitioners (Settlement Agreement §§ 2.5, 2.6). Specifically, the Joint Petitioners agreed to provide to the Attorney General and the Department, in conjunction with Fall River's Annual Return to the Department, certain information regarding the allocation of costs to the Fall River division of the surviving corporation (*id.*). Further, given that the Joint Petitioners are not requesting approval of a rate plan or any other ratemaking treatment of merger-related costs as part of the requested relief in this proceeding, the Joint Petitioners and the Attorney General agreed that neither party would be precluded, by virtue of the Settlement Agreement, from taking any position in future proceedings with regard to rates or ratemaking treatment of merger-related costs, including the acquisition premium, that may be proposed by Fall River and Southern Union (*id.* §§ 2.3, 2.4).

### III. JOINT PETITIONERS' MERGER PROPOSAL

The Agreement of Merger by and between Southern Union and Fall River dated October 4, 1999 ("Merger Agreement") provides that Fall River will be merged with and into Southern Union, with Southern Union as the surviving corporation (Exh. SU/FR-5, at § 2.1). Southern Union is a natural gas local distribution company, incorporated under the laws of the State of Delaware and in existence since 1929, with a principal place of business in Austin, Texas (Exh. SU/FR-1, at 2). Southern Union currently serves approximately 1.2 million natural gas customers through four operating divisions in: (1) Texas as Southern Union Gas Company, serving approximately 523,000 customers; (2) Missouri as Missouri Gas Energy, serving approximately 487,000 customers; (3) Florida as South Florida Natural Gas, serving approximately 5,000 customers; and (4) Pennsylvania as PG Energy, serving approximately 154,000 customers (*id.* at 2-3). In addition to its natural gas distribution divisions, Southern Union also has several energy-related, non-utility subsidiaries (*id.* at 3; SU/FR-6 (describing Southern Union's subsidiaries)).

Fall River, incorporated in Massachusetts in 1880, serves approximately 47,000 customers in Fall River, Somerset, Swansea and Westport. (Exh. SU/FR-3, at 3). The Fall River-Southern Union proposal differs from other merger proposals made to the Department in that Southern Union operates as a utility in several jurisdictions, but is not organized as a holding company (Exh. SU/FR-1, at 2-3, 10-11; Exh. SU/FR-2, at 6-7; Exh. DTE-2-35; Tr. at 20-24). Southern Union, therefore, will conduct Fall River's gas utility business as an operating division of Southern Union (Exh. DTE-2-35, 37). The Fall River division of Southern Union would be fully subject to the Department's regulatory jurisdiction under G.L. c. 164 (Exh. DTE-2-2).

Southern Union also is in the process of merging with Providence Energy Corporation ("ProvEnergy"), the sole owner of North Attleboro (and Providence Gas Company), and Valley Resources, Inc. The latter is a holding company operating two LDCs located in

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Rhode Island within 30 miles of Fall River (Valley Gas Company and Bristol and Warren Gas Company). These companies, along with Fall River, would be operated independently, at least in the near term, but as a part of a New England business unit of Southern Union (Exh. SU/FR-1, at 10-11; Exh. DTE-2-35; Exh. DTE-2-37).

The record shows that the total price to be paid in this transaction, and the acquisition premium resulting from that purchase price, are reasonable and consistent with those in other recent mergers, including those previously approved by the Department. (Exh. SU/FR-2, at 5-6; RR-DTE-2). In recent mergers, buyers have paid multiples of between 19.6 and 39.2 of earnings, with an average of 28.9 (Exh. SU/FR-2, at 5). The corresponding measure for the Fall River acquisition is 24.4, which is below the average. With regard to price-to-book value multiples, the merger entails a multiple of 2.8, which is slightly above but still within the range in recent mergers (id.). An additional measure of utility transaction value is the price paid per customer. The use of this measure is predicated on the belief that access to customers is a major driver of the future value of a utility. In recent mergers, this measure averaged approximately \$3,100 per customer (id.). The Southern Union-Fall River merger reflects a price per customer of \$1,483, which is below the average (id.). The ratio of the acquisition premium to the total price for Fall River is 0.47, which equals the average for the transactions listed in RR-DTE-2. The range for those transactions is 0.35 to 0.64 (RR-DTE-2). These comparisons show that the price offered for Fall River, and the acquisition premium reflected in that price, are consistent with recent market valuations for gas distribution properties, and therefore are fair and reasonable.

Fall River and Southern Union are committed to ensuring quality customer service for Fall River's customers. (Exh. SU/FR-2, at 20-21; Exh. SU/FR-3, at 10-12). The Joint Petitioners propose to establish a service quality index ("SQI") pursuant to which key customer service measures would be monitored and financial incentives would be applied to avoid any degradation of service. (Exh. SU/FR-3, at 11-12). This SQI proposal is consistent with SQI proposals presented as part of other mergers the Department has recently approved. See Eastern-Essex Acquisition, D.T.E. 98-27, at 32 (1998); Eastern Colonial Acquisition, D.T.E. 98-128, at 74 (1999). In order to allow for time to gather the necessary data to provide a full service quality plan, the Joint Petitioners propose that the Department review the service quality plan 18 months following the close of the merger (Exh. SU/FR-3 at 11). The SQI would consist of 1) telephone response time; 2) service appointments met as scheduled; 3) response time for emergency calls; 4) lost time accidents; and 5) on-cycle meter reading (id.). The SQI would provide the Department with a basis for comparison of post-merger service quality to performance by Fall River before the merger (id.).

The Joint Petitioners' application for approval of the proposed merger under G.L. c. 164, § 96 does not include a proposed rate plan, nor have the Joint Petitioners requested recovery of the acquisition premium or other merger-related costs (Exh. SU/FR-2, at 17). Instead, the Joint Petitioners state that they plan to propose, at a future juncture, a performance-based ratemaking ("PBR") plan that would provide incentives to increase operating efficiencies while maintaining quality customer service and system integrity with a corresponding opportunity to increase shareholder earnings (id. at 17-18; Tr. at 39-45).

However, as noted above, the Joint Petitioners are not seeking the Department's approval of a PBR plan or any other ratemaking treatment in this proceeding. The Joint Petitioners are requesting only that the Department indicate in its order in this proceeding that Southern Union will not be precluded from proposing a PBR plan, or a rate plan that will allow for the recovery of merger-related costs in future ratemaking proceedings (to the extent that savings are demonstrated to have resulted from the merger), merely because the Joint Petitioners have deferred this matter to a future time when consideration of ratemaking issues becomes appropriate.

#### IV. THE MERGER PROPOSAL IS CONSISTENT WITH THE PUBLIC INTEREST.

## A. Standard of Review

The Department has authority to review and approve mergers and acquisitions under G.L. c. 164, § 96, which, as a condition for approval, requires the Department to find that mergers and acquisitions are "consistent with the public interest." Boston Edison-Commonwealth Acquisition, D.T.E. 99-19, at 10 (1999); Eastern-Colonial Acquisition, D.T.E. 98-128, at 4-5 (1999); NIPSCO-Bay State Acquisition, D.T.E. 98-31, at 9; Eastern-Essex Acquisition, D.T.E. 98-27, at 8. In Boston Edison Company, D.P.U. 850, at 6-8 (1983), the Department construed the public-interest standard embodied in G.L. c. 164, § 96 as requiring a balancing of the costs and benefits attendant to any proposed merger or acquisition. Boston Edison-Commonwealth Acquisition at 10; Eastern-Colonial Acquisition at 5. The Department has stated that the core of the consistency standard is the "avoidance of harm to the public." Id.; D.P.U. 850, at 5. Therefore, under the terms of D.P.U. 850, a proposed merger or acquisition is allowed to go forward upon a finding by the Department that the public interest would be at least as well served by approval of a proposal as by its denial. D.P.U. 850, at 5-8; Boston Edison-Commonwealth Acquisition at 10; Eastern-Colonial Acquisition at 5; NIPSCO-Bay State Acquisition at 9; Eastern-Essex Acquisition at 8. The Department has reaffirmed that it would consider the potential gains and losses of a proposed merger to determine whether the proposed transaction satisfies the G.L. c. 164, § 96 standard. Id.; Boston Edison Company, D.P.U./D.T.E. 97-63, at 7 (1998). Thus, the public-interest standard, as elucidated in D.P.U. 850, must be understood as a "no net harm," rather than a "net benefit" test. Boston Edison-Commonwealth Acquisition at 10-11; Eastern-Colonial Acquisition at 5; NIPSCO-Bay State Acquisition at 9-10; Eastern-Essex Acquisition at 8.

The Department considers the special factors of an individual proposal to determine whether it is consistent with the public interest. Boston Edison-Commonwealth Acquisition at 11; Eastern-Colonial Acquisition at 5; NIPSCO-Bay State Acquisition at 9-10; Eastern-Essex Acquisition at 8; D.P.U./D.T.E. 97-63, at 7; Mergers and Acquisitions, D.P.U. 93-167-A, at 7-9 (1994). To meet this standard, costs or disadvantages of a proposed merger must be accompanied by offsetting benefits that warrant their allowance. Boston Edison-Commonwealth Acquisition at 11; Eastern-Colonial Acquisition at 5; NIPSCO-Bay State Acquisition at 9-10; Eastern-Essex Acquisition at 8; D.P.U./D.T.E. 97-63, at 7; Mergers and Acquisitions, at 18-19. Various factors may be considered in determining whether a proposed merger or acquisition is consistent with the public interest pursuant to G.L. c. 164, § 96. As set forth in Mergers and Acquisitions, these factors include: (1) effect on rates; (2) effect on service quality; (3) resulting net savings; (4) effect on competition; (5) financial integrity of the post-merger entity; (6) fairness of the distribution of resulting benefits between shareholders and ratepayers; (7) societal costs, such as job loss; (8) effect on economic development; and (9) alternatives to the merger or acquisition. Boston Edison-Commonwealth Acquisition at 11-12; Eastern-Colonial Acquisition at 6; NIPSCO-Bay State Acquisition at 10; Eastern-Essex Acquisition at 8-9; D.P.U./D.T.E. 97-63, at 7-8; Mergers and Acquisitions at 7-9. The Department has stated that this list is illustrative and not exhaustive, and that the Department may consider other factors, or a subset of these factors, when evaluating a G.L. c. § 96 proposal. Boston Edison-Commonwealth Acquisition at 12; Eastern-Colonial Acquisition at 6; NIPSCO-Bay State Acquisition at 10; Eastern-Essex Acquisition at 9; Mergers and Acquisitions at 9. In addition, the Department has stated that, among these factors, it would consider societal costs, such as job loss. Boston Edison-Commonwealth Acquisition at 12. Thus, proponents of mergers or acquisitions must demonstrate that they have a plan for minimizing the effect of job displacement on employees. Id.

The Department's determination that the merger or acquisition meets the requirements of G.L. c. 164, § 96 must rest on a record that quantifies costs and benefits to the extent that such quantification can be made. Eastern-Colonial Acquisition at 7; NIPSCO-Bay State Acquisition at 11; Eastern-Essex Acquisition at 10. To avoid an adverse result, a petitioner cannot rest its case on generalities, but must instead demonstrate benefits that justify the costs, including the cost of any acquisition premium sought. Id.; Mergers and Acquisitions at 7.

B. The Proposed Merger Meets the Public-Interest Standard Established by the Department

The proposal before the Department meets the public-interest standard established by the Department and should be approved. As discussed below, the merger proposal satisfies all aspects of the Department's nine-factor public-interest test because customers will experience no net harm as a result of the merger.

1. Effect on Rates

The record in this proceeding demonstrates that the proposed merger will not adversely impact the rates charged to customers. If the merger had not taken place, Fall River would probably have been forced to file a request for a rate increase of approximately \$2,000,000 (Exh. SU/FR-3, at 9). Although the record shows that Southern Union will incur merger-related transaction costs, including the acquisition premium, the Joint Petitioners are not proposing a rate plan or other ratemaking treatment as part of their application for approval of the merger (Exh. SU/FR-2, at 19). Rather, consistent with Southern Union's management approach in other acquisitions, Southern Union is seeking the opportunity to propose, in the future, a mechanism that would encourage operational and performance improvements, whether merger-related or non-merger-related, for the benefit of both customers and shareholders (Exh. SU/FR-1, at 7-8; Exh. SU/FR-2, at 18; Tr. at 42-44). Therefore, as discussed previously, Southern Union has requested only that, in approving the merger, the Department find that Southern Union is not precluded from proposing in the future a PBR plan, or a rate plan that would allow for the recovery of merger-related costs to the extent that such costs are demonstrated to be offset by merger-related savings (Tr. at 42-44). See NIPSCO-Bay State Acquisition at 45-46. Thus, Fall River's current base rates will remain in effect after the merger (SU/FR-2, at 19), and, in the future, no change to base rates may occur absent Department investigation and approval.

With regard to the Cost of Gas Adjustment ("CGA") factor, the record demonstrates that the merger will create the potential for gas-cost synergies between the merging companies, which would inure entirely to the benefit of customers by operation of the CGA (Exh. SU/FR-4, at 3-11; Tr. at 92-100). The record also demonstrates that there is no potential for gas costs to be higher than otherwise would have been experienced as a result of the merger because the companies will continue to purchase gas supplies in accordance with their existing gas-supply resources and only those coordination or consolidation efforts that would work to reduce costs will be implemented (Exh. SU/FR-4, at 4-5; Exh. DTE-2-9, 52; Exh. DTE-4-, 5, 6). Accordingly, the record supports a finding by the Department that the merger will have no adverse impact on the rates charged to Fall River customers, and that in fact, the merger creates the potential for cost reductions that would not be available to customers in the absence of the merger.

2. Effect on Quality of Service

The record demonstrates that the Joint Petitioners will put in place a service-quality measurement and monitoring program to ensure that there is no degradation in service quality as a result of the merger. The record indicates that Southern Union has emphasized quality customer service in the form of safe, reliable service at a low cost, as a key to its success in the energy marketplace (Exh. SU/FR-1, at 3; Tr. at 65). Moreover, Fall River proposes to implement the necessary systems and processes to track the necessary service-quality data and to submit such data to the Department for its review, consistent with the Department's decision in Eastern-Essex Acquisition regarding the implementation of a service quality measurement program for Essex. (Exh. SU/FR-3, at 10-12). D.T.E. 98-27, at 32-34. Further, Fall River, which has always provided excellent customer service, looks forward to taking advantage of the increased resources which Southern Union can provide, to bring a higher level of service to its customers (see, e.g., Tr. at 28-31). Thus, Fall River believes that, as a direct result of the merger, the Department will see an overall improvement in the level of service quality and service offerings being delivered to its customers over the long term.

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A key factor in Southern Union's approach for improving operating efficiencies and providing outstanding customer service is the use of technology. The record demonstrates that Southern Union has the resources and the experience to implement information systems that promote operational efficiency and enhance service to customers (Exh. SU/FR-1, at 7-8; Tr. at 28-31, 33-34). For instance, Southern Union installed automated meter reading systems throughout its Missouri properties, achieving its objective of enhancing customer service by ensuring timely and accurate billing (Exh. SU/FR-1, at 7-8). Southern Union is also developing a service, which Southern Union expects to provide in the future to Fall River customers, that will enable customers to schedule specific appointment times through the Internet, and thus will provide greater convenience to the customer and make more efficient use of service personnel (Tr. at 28-32). Accordingly, the record supports a finding by the Department that service quality will not be diminished as a result of the merger.

### 3. Resulting Net Savings

The record demonstrates that, although Southern Union pursued a merger with Fall River primarily for strategic purposes, cost savings will be available over the long term as a result of the merger. Similar to the circumstances of the NIPSCO-Bay State merger approved by the Department, the merger of Southern Union with Fall River will expand the geographic diversity of Southern Union's operations to include New England with its southwest, southeast, and the mid-Atlantic regions, thereby reducing the effect on Southern Union's revenues of adverse economic or weather conditions in a particular part of the country (Exh. SU/FR-1, at 9-10; Exh. SU/FR-2, at 13-14; Exh. DTE-2-35, 37). Moreover, Southern Union and Fall River recognize that each share similar business perspectives, providing the opportunity for both to improve upon their present operations by drawing from each other's strengths.

Significantly, notwithstanding the fact that the merger is being undertaken primarily for strategic purposes, the record demonstrates that synergistic savings will be available such as those associated with the elimination of certain "public company" functions, which will be performed by Southern Union on a consolidated basis after the merger (Exh. SU/FR-2, at 14-15). Both Southern Union and Fall River incur annual expenses associated with their respective boards of directors, annual shareholder meetings, preparation and processing of required public filings (such as annual reports, proxies and other SEC filings), stock exchange listings, and stock transfer agents (i.d.). These functions will no longer be separately performed by Fall River, and instead, Fall River will be responsible only for an allocated share of Southern Union's expenses associated with these functions (i.d.). Additionally, Fall River will save expenses through single memberships in the American Gas Association and the New England Gas Association and through Southern Union's lower commitment fees on its credit line (i.d.). Accordingly, the record demonstrates that estimated annual net savings of over \$100,000 for Fall River are anticipated to result from these measures (i.d.).

With regard to gas-cost savings, the Department has previously recognized that there is a likelihood of achieving savings as a result of the joint management and purchasing of gas supplies which result in greater economies and efficiencies. NIPSCO-Bay State Acquisition at 14. The Department concluded that "with respect to gas costs, ratepayers are likely to be better off, not worse off, as a result of the merger." Id. Similarly, here, the record demonstrates that the merger will create the potential and opportunity for gas-cost savings that would inure to the benefit of customers through the operation of the CGA. As a result, customers will be better off as a result of the merger with Southern Union. Thus, the record supports a finding that the merger will create the potential for net cost savings and, in no event, will it result in a net harm for customers.

### 4. Effect on Competition

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The record demonstrates that the proposed merger will not adversely affect competition in the gas industry. Southern Union has a history of promoting customer choice and unbundling initiatives, which support competition in the gas industry (Exh. SU/FR-2, at 21-22). The record indicates that Southern Union's entry into the Massachusetts market by virtue of the proposed merger will involve a significant contribution to the Commonwealth's gas customers as a result of investment in additional technology and commitment to and experience with customer choice (id.; Tr. at 28-32). Accordingly, the record supports a finding that the proposed merger will have a positive effect on competition within the natural gas industry in Massachusetts.

#### 5. Financial Integrity of Post-Merger Entity

The record demonstrates that the proposed merger will have a positive impact on the financial integrity of Fall River as a result of the merger. Specifically, Fall River will be joining a \$2.5 billion company, which will serve approximately 1.6 million customers (Exh. SU/FR-2, at 20). Thus, Fall River will enjoy greater financial stability and flexibility as a result of joining Southern Union, which will lead to cost savings over time, because, among other things, of the ability to obtain financing on more favorable terms and conditions (id.). For a discussion of other factors bearing on post-merger financial integrity, see Exh. DTE-2-45, 49.

Moreover, the record indicates that the proposed merger will strengthen the financial integrity of Southern Union as a whole because the merger will expand Southern Union's geographic diversity and minimize the effects of adverse economic or weather conditions in any one region (Exh. SU/FR-1, at 9). This will have the effect of minimizing Southern Union's short-term risk and enhancing its long-term financial strength (id.; Exh. SU/FR-2, at 20; Exh. DTE-2-45, 49; Tr. at 61-62).

#### 6. Fairness of the Distribution of Benefits

The record indicates that benefits resulting from the merger will be fairly distributed between customers and shareholders. In the near term, customers will receive the benefit of enhanced gas-supply reliability and are likely to benefit from lower gas costs as coordination efforts progress (Exh. SU/FR-2, at 3). In the long term, customers will benefit from reduced "public company" function costs and other potential cost reductions resulting from consolidation efforts over time (Exh. SU/FR-2, at 14-15, 23-24). Shareholders and customers will share in the benefits resulting from having a financially strong post-merger entity with substantial potential for growth in the future (Exh. SU/FR-2, at 23; Exh. SU/FR-3, at 8). Accordingly, the record supports a finding that merger-related benefits are fairly distributed between customers and shareholders.

#### 7. Societal Costs

The record indicates the proposed merger will not produce societal costs in the foreseeable future. For instance, the record shows that job displacement will be minimized because there will be no involuntary layoffs as a result of the merger, as well as the fact that the current level of employee benefits will be maintained (Exh. SU/FR-2, at 22; Tr. at 34-35, 71, 72). Moreover, local management will maintain responsibility for operations, including staffing decisions (Exh. SU/FR-2, at 23; Tr. at 38-39). Societal costs typically result when a merger causes involuntary employee reductions that are accomplished without programs, such as outplacement programs and retraining support, to provide assistance to displaced employees. Southern Union did not enter the merger with the intent of achieving cost savings through employee layoffs. Future developments in the business, including customer demands and new technologies, will drive staffing needs and levels. At the same time, Fall River employees will have improved career opportunities as a result of being a part of a larger, growing organization (id.). Accordingly, the record supports a finding that there will be no adverse effect on Fall River's workforce or negative societal costs as a result of the merger.

#### 8. Effect on Economic Development

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The record indicates that the proposed merger will have a positive impact on economic development in Fall River's service territory. By keeping rates and gas costs low and prioritizing quality customer service and the introduction of technological improvements, the merged entity will contribute to development of the local economy (Exh. SU/FR-1, at 8). Further, Southern Union encourages its employees to participate in local community organizations, such as chambers of commerce and development boards, to improve the economic outlook of an area and attract new business to the area (Exh. SU/FR-2, at 23; Exh. DTE-2-6). Therefore, the record supports a finding that the proposed merger will have a positive affect on economic development.

### 9. Alternatives to the Merger

Fall River cannot achieve the benefits available through the merger in an alternative non-merger method (Exh. SU/FR-2, at 23-24; Exh. SU/FR-3, at 5-7). Fall River's business combination with Southern Union is the best means to access new technologies that can provide enhanced customer service and increased productivity (Exh. SU/FR-2, at 23-24; Exh. SU/FR-3, at 5-7). For instance, smaller companies generally do not have access to the financing capabilities, operating efficiencies, and flexibility of a larger company (id.). Also, smaller companies cannot economically implement many of the new technologies that improve the efficiency of operations and/or enhance customer service (id.). Absent the merger, the gas supply benefits and the savings associated with the elimination of duplicative "public functions" previously discussed would not materialize (id.). Other merger-related savings that may materialize over time will be made possible only because of economies achieved as a result of the merger (id.). For example, the capital costs to implement automated meter reading ("AMR") and workforce automation are extremely imposing for a company the size of Fall River, whose customer base is relatively limited. Southern Union, with its greater resources, is in a better position to determine when and how to implement AMR, and is in a better position to implement technological advances such as the workforce automation project that Southern Union currently is developing. (Exh. SU/FR-1 at 7-8; Tr. at 28-32). Moreover, this position will be enhanced if, as expected, Southern Union completes the merger transactions with ProvEnergy and Valley Resources where AMR and workforce automation also could be implemented. Accordingly, the record supports a finding that there is no alternative that would produce the benefits that are potentially available as a result of the merger.

### BRIEFING ISSUES POSED BY THE DEPARTMENT

A. Please address as a jurisdictional matter the approval of financings in a context where regulatory jurisdictions may enter conflicting orders.

At the June 2, 2000 hearing, the Department requested that the Joint Petitioners address one specific issue that could arise in the context of the need for review by certain jurisdictions of prospective Southern Union financing proposals, i.e., the effect of the failure of an individual jurisdiction to approve a financing proposal that another jurisdiction has approved (Tr. at 78). This potential conflict should be of minimal concern to the Department, however, because (like the merger-approval process), if the matter requires approval of several state regulatory commissions and one approval is lacking, then the transaction cannot proceed (see id. at 58). In a situation where approval is given but on differing terms or conditions, then the transaction could proceed provided that all terms and conditions were satisfied. If the specified terms and conditions of different jurisdictions directly conflicted, however, (although Southern Union cannot envision any circumstance in which a direct conflict, as opposed to different requirements, would arise), then, as with any conflict-of-laws issue, a conflict-of-laws analysis would become necessary. It is important to note that out-of-state companies do business in Massachusetts regularly, and therefore, this issue is not a novel one outside of the public utilities arena. To the extent that it is possible that such an unlikely event may occur, such instances would be few and far between and resolvable under a conflict-of-laws analysis.



B. Additional Regulatory Jurisdiction Issues

The Department has previously identified certain issues that may arise in the context of regulating an operating division or divisions of a foreign corporation, including the nature and scope of the Department's regulation of the parent corporation's capital structure, cost allocations between operating divisions, and coordination between the Department and other state regulatory commissions. NIPSCO-Bay State Acquisition at 28. Southern Union recognizes that, by doing business as a public utility within the Commonwealth of Massachusetts, Southern Union will be subject to the Department's jurisdiction over those matters that have been delegated to the Department under Massachusetts law. Southern Union, now operating as a public utility in Texas, Missouri, Florida and Pennsylvania, also recognizes that certain regulatory requirements differ in various states and is experienced in complying with the regulatory requirements in each of the states in which it operates.

G.L. c. 164 grants to the Department general supervisory authority over gas companies. See, e.g., G.L. c. 164, § 76. The Department's authority includes regulation of prices charged by gas companies for service within the Commonwealth and enforcement of safety, consumer protection and various reporting requirements. See G.L. c. 164. As a provider of public utility service, Southern Union recognizes those service obligations and the important role of the Department in overseeing the delivery of such services. Thus, Southern Union acknowledges that it will be subject to the Department's regulatory authority following the closing of the merger, including the Department's authority to regulate Southern Union's rates for service in the Commonwealth (Exh. DTE-2-2).

Moreover, in certain particular areas, such as review and approval of financing proposals and of rate proposals and attendant cost allocation issues, the Department has expressed an interest in preserving its regulatory jurisdiction. See NIPSCO-Bay State Acquisition at 25. Southern Union has specifically affirmed that the Department will maintain its regulatory jurisdiction over Southern Union to ensure satisfaction of legal obligations applicable in these areas (Exh. DTE-2-2). With respect to financing, Chapter 164 restricts a gas company's ability to purchase securities, issue long term securities, or lend money to or guarantee the debt of any other entity. Southern Union will abide by the requirements imposed by Chapter 164 with regard to financings that will be consummated following the closing on the proposed merger transaction. Southern Union envisions that, in the future, such proceedings will impose a minimal burden upon the Department (Exh. SU/FR-2, at 6-9).

First, Southern Union's filings should be infrequent. Southern Union has historically financed its ongoing capital expenditures with cash flow from operations. Although Southern Union enters the market on occasion to refinance obligations when economical, the primary reason that it seeks long term financing is to fund major acquisitions of gas distribution properties, which Southern Union does not anticipate occurring in the near term.

Second, Southern Union has had experience in seeking financing approvals before regulatory bodies. For instance, Southern Union must seek approvals for financing proposals in Florida and Pennsylvania. Regulators in these states examine a financing proposal by assessing its impact on the financial integrity of the consolidated company, determining that the financing will not impair the provision of utility services, and/or confirming that the financing is needed to meet the utility's capital needs. By appropriately reserving the ratemaking issues associated with any financing to future ratemaking proceedings, Southern Union's regulators have been able to address these threshold questions on a reasonably streamlined basis. The same approach could easily be applied in Massachusetts, along with a straightforward showing that no capital impairment would result.

Third, review processes can be established to satisfy regulatory requirements without causing unnecessary resources to be devoted to examination. In both Florida and Pennsylvania, for example, Southern Union has been able to satisfy regulatory commission staffs largely through informal processes that have been more efficient

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and less time consuming than formal discovery and litigation processes. Southern Union intends to emulate this experience by working cooperatively with the Department to produce similar streamlined processes in Massachusetts, including, if required by the Department, completion of hearings on a simplified basis.

A second jurisdictional issue relates to the inclusion in rates of an allocation of costs from an out-of-state entity. Here too, the regulation would not differ substantially from existing regulation. Local area plant costs would be separately identified and reflect facilities used for Fall River operations. To the extent that certain operating or administrative costs are shared, rather than directly charged, those costs would be allocated on a consistent basis throughout the Southern Union system (Exh. SU/FR-2, at 11-13; Exh. 2-19; Tr. at 25-27). Southern Union's allocation methods, which would be applied in Massachusetts, have been used by various state regulatory authorities (Exh. SU/FR-2, at 11-13; Exh. DTE-2-19). The Department has approved similar allocation methods in the past and continues to resolve such allocation issues on a recurring basis. See Commonwealth Electric Co., D.P.U. 90-331, at 79 (1991).

Moreover, Southern Union has testified that from its experience and understanding, for purposes of cost allocation, there is little, if any, distinction in the process of allocation among different operating divisions of a single utility company as compared to the same process for separate holding company subsidiaries. Given recent utility merger activity in Massachusetts and the Department's experience in reviewing allocations among in-state and out-of-state utility holdings, cost allocation among operating entities and corporate organizations in different states has become relatively routine and should not present any different issues in kind or substance merely because the allocations are being presented as among operating divisions rather than subsidiaries. It should be noted that the Joint Petitioners have agreed with the Attorney General to provide considerable information on an annual basis concerning the allocation of joint and common costs among Southern Union's regulated and nonregulated operations, regardless of whether a rate proceeding is instituted, in order to enhance the capability of the Department and the Attorney General to monitor and review such allocations during the reporting period ( see Settlement Agreement § 2.5).

One other aspect of ratemaking that would necessarily change is establishment of a capital structure for Fall River. Though the Fall River division would not have its own capital structure, Southern Union's consolidated capital structure or an industry structure based on comparable local distribution companies could reasonably be used to establish a cost of capital as long as debt, preferred, and common equity cost rates are appropriately matched to the selected capital structure.

The Joint Petitioners have also addressed many other aspects of regulating a public utility company with multiple state operations (see Exh. DTE-2-3). Among these are that G.L. c. 164, § 80 requires that a gas company maintain an office in a town within its service territory; keep in that office all records required by Massachusetts law unless otherwise authorized by the Department; and make the company's records available for examination by the Department at all reasonable times. In addition, G.L. c. 164, § 85 provides that the Department may authorize its employees to examine the books and records of any company subject to G.L. c. 164, as well as the books and records of any affiliated company with respect to affiliate transactions.

Although operating as the Fall River division of Southern Union, a local office within Fall River's service territory would be maintained, as well as local retention of Fall River's books and records. While Fall River's accounting processes may ultimately be integrated into Southern Union's system, such records would be readily accessible in Massachusetts through the Southern Union's computer network. In addition, Southern Union will provide to the Department such access to the corporate books and records as is necessary for the Department to examine the basis for allocated joint and common costs, as well as affiliate transactions, if any. To the extent that invoices and other supporting materials are maintained at Southern Union's corporate office in Austin, Texas, these materials will be made available to

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the Department upon request and with reasonable notice.

Southern Union will comply with and be subject to applicable safety-related operational laws (see G.L. c. 164, § 105A) and consumer protection laws and rules such as the billing and termination laws (G.L. c. 164, § 124 et seq.) as well as the Department's Billing and Termination Regulations (220 CMR 25.00 et seq.) and the Department's Security Deposit Regulations (220 CMR 26.00 et seq.). Additionally, the general supervisory authority granted to the Department by G.L. c. 164, § 76 appears to be broad enough to encompass enforcement of the rights of Massachusetts consumers. Pursuant to G.L. c. 164, §§ 1F, 92, 92A, 93, and 94, consumers may complain to the Department regarding service and gas quality issues, or the Department may initiate its own investigations without consumer complaints. Southern Union submits that for these important concerns, there will be no difference in the application of requirements to Southern Union's Fall River division from their application currently to Fall River.

Still another potential regulatory concern is that under G.L. c. 164, § 94B, no gas company shall enter into a contract with an affiliate covering a term of more than one year unless such contract permits the compensation paid under such contract to be reviewed by the Department. This section also requires prior Department approval of any affiliate contract having a term of more than one year. The Department has the power to examine and require termination of long-term affiliate contracts if the compensation to be paid to the affiliate is excessive.

In general, Southern Union subsidiaries will have very few contracts with such "affiliates." Thus, for example, in the area of corporate services, Southern Union has testified that in light of its divisional structure, there are no affiliate agreements for corporate services. As previously discussed, the costs of these joint and common services are included in Southern Union's joint and common cost model, which is used to allocate these costs to the various Southern Union entities (Exh. SU/FR-2, at 11-13; Settlement Agreement § 2.5, including Exhibits A and B). If the Fall River division subsequently engages in any affiliate transaction with a Southern Union subsidiary, the contract will be made in compliance with the provisions of § 94B. In addition, to the extent that any joint and common costs involving an affiliate transaction (but not a transaction involving Fall River) are allocated to Fall River, Southern Union will provide information to support the reasonableness of the cost and resulting allocation in future Fall River general rate proceedings.

## VI. CONCLUSION

The record in this proceeding demonstrates that customers will experience no net harm as a result of the proposed merger. As set forth above, customers will experience no adverse impact on rates and are likely to benefit from gas-cost savings in the near future. Ratemaking issues will be deferred to a future proceeding. In addition, there will be no adverse impact on service quality as a result of the mergers. Customers have the potential to benefit from the increased size of the combined entity and its strengthened financing capabilities. Technology initiatives are likely to improve customer service and to result in greater efficiency on a more economical basis than could have been achieved by Fall River in the absence of the merger.

Therefore the Joint Petitioners request that the Department:

(1) Determine that the merger of Fall River with and into Southern Union is consistent with the public interest, and is authorized and approved pursuant to G.L. c. 164, § 96;

(2) Confirm that Southern Union, as the surviving corporation of the merger, will continue to have all the franchise rights and obligations that were previously held by Fall River, and that further action, pursuant to G.L. c. 164, § 21, is not

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required to consummate the merger; and  
(3) Grant such further relief as the Department may deem lawful and just.

Respectfully Submitted

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